A Study on Financial Analysis and Risk Management of selected Small Finance Bank through CAMEL Model approach

Session - 2022-2023

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Shri Vaishnav Vidyapeeth Vishwavidyalaya, Indore
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Commerce

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DECLARATION

I **Shaily Jhawar** registered as a research scholar (enrollment No. 2105PHDCM10535) in Shri Vaishnav Vidyapeeth Vishwavidyalaya, Indore, do hereby declare that this synopsis is submitted in the partial fulfilment for the award of the degreeof Doctor of Philosophy in Commerce as prescribed by the university.

I hereby declare that work which is being presented in the Synopsis entitled **"A Study on Financial Analysis and Risk Management of selected Small Finance Bank through CAMEL Model approach"** is carried out by me. I further declare that to the best of my knowledge and belief, the synopsis does not contain any work which has been submitted for the award of any degree either in this University or in any other University/ Deemed University without proper citation.

I also declare that the text, tables or any other material taken from other sources (inhaling but not limited to books, journals and websites) have been acknowledged, referred and cited to the best of my knowledge and understanding.

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Plagiarism Report

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Shaily Jhawar

SHRI VAISHNAV VIDYAPEETH VISHWAVIDYALAYA, INDORE

CERTIFICATE

This is to certify that the synopsis entitled **"A Study on Financial Analysis and Risk Management of selected Small Finance Bank through CAMEL Model approach."** has been written by **Shaily Jhawar** (**2105PHDCM10535**) under my supervision and guidance. The synopsis is her original work completed after careful research and investigation. The standard of the work is as expected from a candidate for the course work of Ph.D. degree. I recommend that the synopsis must be sent for evaluation.

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1. CONCEPTUAL FRAMEWORK

1.1 Introduction

Banking is as old as civilization itself, and it's been a financial institution for the longest time. India's banking sector started back in the '90s and has been going strong ever since.. As a result of these reforms, the Indian banking sector has changed all over with regard to its bye laws, organisational arrangements, size and activity levels. It was possible to trace its origins in the old days. In modern society, banking institutions are essential.

In developing countries, it has a crucial role to play. Today banks are not just the merchants of money, they're also creating credit. The primary task of the Bank is to ensure that it receives as much deposits from customers as possible and thus mobilises them for its most advantageous, profitable sector. It is a financial institution, which will accept deposits from citizens and provide credit to them. Banking institutions deal in cash, so they're money dealers. However, the bank's functions have been growing and diversifying with time.

Financial stability and performance assessment, which will have a significant impact on the entire national economy, determines to what extent banks are able to compete for market share and play an essential role in developing this sector. The assessment of each bank's financial position and the proper management of it are constantly undertaken in response to this observation.“The performance analysis of banks are important to the policy-makers to identify the success or failure of bank and to adopt good strategies so that the bank can be successful. Whether the efficiency and performance of the Indian banking sector are in accordance with the regulatory framework or not is an essential part to be known”. (Malhotra and Aspal, 2014)

In general, a bank is an institution that provides core banking services such as deposit taking or lending to the public and In economic development of a country, banking systems play an important role. Over the years, India's banking industry has continued to grow at an exceptional rate. Using a regulatory banking oversight system, banks are evaluated to see how efficient they are.. The Bank itself is a body which performs any or all of the various banking functions like receiving, transferring, investing, paying, collecting, lending, dealing, exchanging and servicing of safety deposits. A country’s banking system is the backbone of its economy, as it encompasses all aspects of society’s credit needs. Developments in the banking sector contribute to our society.

Small business units, little and marginal also serve sections of society not provided by traditional banks. Farmers, micro and small business industries as

well as the unorganized sector. In line with India's financial inclusion initiative, changes in banking and finance are taking place across the country. One of the main keys is Pradhan Mantri Jan Dhan Yojna, PMJDY Government initiatives began on 28 August 2014 and have been referred to as the largest financial initiative.Recently Indian government initiated with Jan DhanYojna. In just one week, India launched 18.096.130 accounts under its 'Financial Inclusion' initiative and set a new record in the 'Guinness World Records'.“In a situation where financial markets are increasingly becoming more and more integrated, providing a model for measurement or assessment of overall financial performance of a banks is of a big importance for financial markets in general and banking sector in particular” (Gadhia,2015).

Small Finance Banks (SFBs) play a crucial role in promoting financial inclusion and catering to the banking needs of underserved and unbanked populations. These banks are designed to provide basic banking services, micro-credit, and financial products to individuals and small businesses in both rural and urban areas. As SFBs operate in a dynamic and challenging environment, it becomes essential to assess their financial health and risk management practices to ensure their sustainability and resilience.

SFBs are a specialised group of banks that were established by the RBI in 2015 as a part of its efforts to facilitate financial inclusion.. These banks are aimed at providing banking services to the segments of the population, which are under banked including small business, lowincome group of people, households, and individuals in rural and semi-urban areas. Small finance banks’ top priority is to facilitate financial inclusion by providing banking services to underprivileged groups. SFBs are designed to cater specifically to the needs of small borrowers, micro and small enterprises, and individuals with limited banking exposure. They adopt customer-centric business models and innovative delivery channels to ensure convenient and affordable banking services. SFBs play a crucial role in bridging the banking divide between urban and rural areas. By establishing branch networks and leveraging technology, they bring formal banking services closer to previously underserved regions, fostering financial inclusion and economic development.

Small Finance Banks are being a key element of any economy. For this reason, in order to guarantee their financial soundness and stability without any future operational risk which would be unsustainable, its performance assessment and benchmarking are of paramount importance.

1.2 CAMEL Rating System

The CAMEL rating system is a widely used framework for assessing the financial health and performance of banks. It provides a structured and comprehensive evaluation of various aspects of a bank's operations, risk management practices, and overall stability. The term CAMEL is an acronym for Capital Adequacy, Asset Quality, Management, Earnings, and Liquidity.

Capital Adequacy: This component of the CAMEL rating system evaluates a bank's capital structure and determines if it has sufficient capital to absorb potential losses. It assesses factors such as the bank's capital adequacy ratio, tier 1 capital, risk-weighted assets, and regulatory capital requirements. The capital adequacy assessment helps determine if the bank is capable of withstanding financial shocks and maintaining stability.

Asset Quality: The asset quality component examines the quality of a bank's loan portfolio and the overall health of its assets. It assesses metrics such as non-performing assets (NPAs), loan loss provisions, asset classification, and risk-weighted assets. The assessment provides insights into the bank's credit risk management practices and the likelihood of loan defaults or asset deterioration.

Management: The management component evaluates the bank's governance structure, risk management practices, and overall management effectiveness. It considers factors such as the competence and integrity of the board of directors, the bank's strategic planning, internal controls, and compliance with regulatory guidelines. The management assessment helps determine if the bank has sound decision-making processes, risk identification and mitigation practices, and effective corporate governance.

Earnings: The earnings component assesses a bank's profitability and ability to generate sustainable earnings. It evaluates metrics such as net interest margin, return on assets, return on equity, and operating efficiency. The assessment provides insights into the bank's revenue streams, expense management, and overall financial performance. It helps determine if the bank is generating sufficient profits to support its operations and capital requirements.

Liquidity: The liquidity component examines a bank's ability to meet its short-

term obligations and manage liquidity risks effectively. It assesses metrics such as the loan-to-deposit ratio, liquidity coverage ratio, and funding sources. The assessment helps determine if the bank has adequate liquidity buffers and sound liquidity risk management practices to handle unforeseen liquidity stress.

Each component of the CAMEL rating system is assigned a rating, typically on a scale of 1 to 5, with 1 indicating a strong performance and 5 indicating a weak performance. The ratings for each component are then aggregated to provide an overall CAMEL rating for the bank. The CAMEL rating system enables regulators, investors, and stakeholders to assess the financial health, risk profile, and overall performance of banks in a standardized and comparable manner.

Regulatory authorities, such as central banks and supervisory agencies, use the CAMEL rating system as a tool to monitor and supervise banks, ensure compliance with regulatory requirements, and identify potential risks to the banking system. The ratings help regulators determine appropriate regulatory actions, such as additional capital requirements, restrictions on activities, or closer supervision for banks with weaker ratings.

In conclusion, the CAMEL rating system is a comprehensive framework that provides a structured and standardized assessment of banks' financial health, risk management practices, and overall stability. It is widely used by regulatory authorities to monitor and supervise banks, promote stability in the financial system, and make informed decisions regarding regulatory interventions.

1.3 Application of CAMEL Model in India

Indian Government's Narsamham Commission Presented Numerous Financial Measures Banking reform focused on improving bank productivity and profitability. Camel model. It was used in a study which was conducted in India to assess the efficiency of Indian banks. Rear Costumers got benefit from improved service quality and newly launched services, according to the report's findings. In order to determine the level of risk associated with financial institutions, the CAMELS rating system is highly effective. In 1996, based on the Padmanabham Working Party's (1995) recommendations, the Reserve Bank of India adopted this method.

Given that the banking sector has an important role to play the economy would be in good shape if some of India's small finance banks were rated and analysed.

Using the reowned CAMEL rating methodology, this study seeks to understand and analyze some of the Indian Small Finance Banks.

Insights into Financial Analysis and Risk Management is a comprehensive study that focuses on evaluating the financial performance and risk management practices of small finance banks in India. Employing the CAMEL model as the analytical framework, the study aims to provide a detailed assessment of these banks' strengths and weaknesses, enabling a deeper understanding of their overall stability and resilience.

The CAMEL Stands for

C – Capital Adequacy

A – Asset Quality

M – Mangaement

E- Earning

L – Liquidity

The implementation of a CAMEL BASE banking rating system has been suggested as a method to evaluate the performance of Jordan's brokerage firms. It is essential that federal and state regulators use the CAMELS credit rating system. Establishing the financial soundness of banks and financial institutions would be supported by supervisory agencies, consumer advocates, employers, stakeholders and researchers.. Many banks have no way of determining their rating, so it is vital to understand how they operate and what actions should be taken if anything goes wrong.A bank's CAMEL's rating shall not be divulged to any higher management, except for this purpose With a view to drawing up business strategies, together with related supervisory staff.

2. REVIEW OF LITERATURE

This chapter reviews the existing literature on Small finance banks and Camel model. Desai and Desai (1989) stated that review is most necessary so that the various problems and matters can be identified and procedure to investigate the research planning can be done. The chapter consists of the concepts of concern data, solved issues, different analysis techniques, findings of the researchers, utilizations of the research findings etc.

Barr et al. (2002) The CAMEL ranking criteria have evolved into a concise and essential tool for regulators and examiners. This rating criterion ensures that the bank is at a good position by finding various aspects of the bank's operations. The financial statements like balance sheet and Profit and Loss account, Cash flow and fund flow statement were detailed.

Sheeba Kapil et al. (2003) reviewed and analysed the present situation In view of the banking reforms. This report provides an analysis of the financial health of the Public Sector Banks (PSBs) in India, forecasting their future financial health and the extent to which they are likely to remain financially sound in the future. The off-site supervisory model of CAMEL was employed to evaluate the financial feasibility of twenty seven public sector banks.

Veni (2004) The importance of the ranking has been pointed out by the author. They've been using this to raise their capital ratios. Government agencies seem to be taking a keen interest in capital adequacy. The ratio analysis is used to take out the credit worth of a bank. The CAMEL model is commonly used for the purposes of assessing banks where capital adequacy is a key component of the bank's ranking.

Prasuna (2004) studied The CAMEL model, which analyses the performance of Indian banks. Since 2003 to 2004, Sixty Five banks have been evaluated in terms of their output. The source claims that there was huge competition, and customers got results and got benefits too. Banks would be providing their consumers a improved service, better quality, innovative goods.

Kapil (2005) The relationship of the CAMEL ratings with bank stock performance has been examined. Based on Offsite analysis, the viability of banks has been analyzed. The model for the supervisory exam is the CAMEL model. all public sector banks, PSBs, are regulated by the government, and also because all the other four components, Capital, Asset, Earning, and Liquidity, reflect the quality of management, the M for management has not been taken into account

in this report. To assess a composite rating, further four components have been analyzed and rated.

Satish et. al. (2005) In order to assess the results of Indian banks, the CAMEL model is used. The study looked at the financial records of Fifty five banks from 2004 to 2005, using CAMEL as their benchmark.. The following conclusions were drawn from these meetings: India's banking system appears strong, and IT will contribute to its growth in the future.

Bodla and Verma (2006) reviewed that the Identification by the Reserve Bank of India of banks were subject to additional supervision. The CAMEL methodology shall identify problems faced by banks and provide a list of solutions. The results of the different banks are shown in a comparative overview. For the period 2000-01 to 2005 he used CAMEL model in order to examine SBI and ICICI's performance. With regards to A competitive advantage has been found for SBI in the area of capital adequacy of ICICI.

P JanakiRamudu and S Durga Rao (2006) The use of small financial institutions (SFB) to Achieve Financial Inclusion in India focuses on the needs of these little banks and their importance. In his research, He found that small financial institutions have a huge potential. Areas with no bank accounts and underserviced areas, In developing the small and medium, they play an important role.

Kimball and James (2007) The relationship between the ownership of the bank in a study carried out in the United Kingdom, patterns and their CAMELS ranking. For the purpose of determining the link between these two data sets, the research has been split in two parts. Different CAMELS parameters and banking form, whether it is publicly or privately owned. In It has been found that there are sufficient resources to sustain this comparison with private sector banks. 58 For the public sector banks, it was simpler.

Derviz et. al (2012) in the long run examined the factors which led to movements of Standard & Poor ‘s and CAMEL bank ratings in the Czech Republic during the period when all three of the biggest banks in the Czech banking sector, accounted for around 60% of the total market size. Assets were privatized within the period from 1998 to 2001.

Balaji (2015) The organisation's performance in the field of finance has been examined What's more, we've discovered the financial strength of the organization, and the weakness of the organization. The examination shows that the benefit is diminished somewhat recently due to increments. In order to be able to make a realistic choice at an appropriate time, the cost and organisation should

ensure the effective functioning of the company, this shortcoming needs to be corrected.

P. Vohra (2015) The financial performance of the banking sector is consistent with the construction of the financial arrangement of any economy, which has an impact on the performance of the economy. A basic basis for the development of banks is in fact ordinary business operations, such as stores and advances. Factors such as development, benefit and level of nonperforming assets are used to assess bank performance in the event that similar examinations should occur at regular intervals.

Himanushu Singh, Pawan Kumar and Jaydeb (2016) The study set up that small financial institutions in India change banking sector and that the challenges faced by them are compliance with the obligatory cash reserve rate and the adoption of cost-effective banking results. The study aimed at determining the challenges faced by small and medium- sized banks in India.

Singh (2015) Profitability means that a company is able to obtain profits for itself proprietors. In general, profitability analysis was the objective of this investigation. In India, the profitability of various private sector banks depends on profit proportion, such as revenue spread, return Profitability is about productivity and control, demonstrating competence or adequacy with respect to the carrying out of business activities. Profitability ratios provide a specific set of valuable information to the financial wellbeing and functioning of an organisation.n on return on net worth, return of resources, and a change in the money margin as well as long term funds.

Prantik Ray (2016) The case study on the metamorphosis of Ujjivan's fiscal services limited to small finance banks and their unborn development in India shall be bandied in this paper. Small finance bank has great findings of these studies have shown that the part of small finance banks has not been addressed in achieving this ideal. fiscal addition in India. In view of this, a study on the backing addition through securitisation installations was carried out in agreement with that background.

Prasuna (2016) During 2003-04 a study was carried out on the performance of Sixty five banks. It was hard to compete as costumers were getting services by the bank authorities.

Dr. P. Ganapathi (2017) reviewed the financial statements recognizing leverage that emerges in financing measures, as well as those which emerge from tasks. The examination yields two utilizing conditions, one for acquiring to account activities and one for acquiring in the course of activities.

Pinal Barot (2017) in the study titled "Financial Inclusion in India" deal with the main objective which was to Understand the importance and extent of Financial Inclusion in India as well as opportunities and challenges where status of financial inclusion in the Indian economy remains unchanged. This is one of the main problems in this country. The lack of access to financial services and financial literacy among the poor only affects a small portion of the population, making the process of financial inclusion difficult for the underprivileged..

Viswan M G (2017) This study focused on small financial banks, specifically ESAF Small Financial Bank, to understand how rural people feel about them and how they operate in Kerala. They used a structured questionnaire to get data from 50 respondents, and then collected information from books, websites, and other sources. The main conclusions of the study were that the RBI and the central government are trying to include weaker sections of the community in financial inclusion programmes to help the economy, but most of the respondents don't know much about ESAF Small Finance Bank.

Abijith S. and Raghavendra N. (2018) Refer to the Empirical Study of Small Financial Institutions chosen by Small Micro Enterprises in Mysore, initiated the introduction, Main tasks, responsibilities and roles of small financial institutions introduced consumer levels notice.

Khan (2018) Small finance banks are specialized banks that are suitable to give introductory fiscal backing in the form of deposits and loans. The purpose of establishing small finance banks in India is to give a fiscal incitement to parts of the population that aren't being serviced by the traditional banks, similar as small specialty units(SUs), small fresh, minor drovers, small ormicro-enterprises, and unincorporated areas.

Jeeban Jyotin Mohanty (2018) The main goal of his study was to figure out why people in India are so financially excluded and why small financial banks are so important. He used a variety of sources to help him do this, like journals, articles from the Reserve Bank of India, the International Monetary Fund, CGAP, and Microsave. Small financial banks also play a big role in helping the Micro Small and Medium Enterprises (MSME) sector grow.

Pahwa (2018) Financial skills are a vital component for the achievement of financial inclusion. The help of small finance banks could make it easier for the government to set up workshops on financial literacy so that individuals can be taught. It sets out new opportunities for it to extend activities and cultivate its image in the unserved Then the government is prepared, too, to carry out this sector and target specialty industries. its arrangements effectively. As a financial

mediator, the small finance banks could bring the under privileged sector of the economy into the ambit of a formal financial framework. It is a win win circumstance for both the partners of banks.

N (2018) The small finance bank is an important part of economic growth. To enhance the presence of the micro, small and medium enterprises sector, it is important to focus on setting up more small money banks in provinces. People in rural areas can easily access basic financial services such as loans, Internet banking, and stores. To improve their financial situation in the sector, small financial banks are essential by helping those who are under or not served.

Amulya (2019) The study has concluded that the SFBs have shown a good performance, indeed in malignancy of controllers' demands on loan size and precedence sector lending. For a more complete understanding of the viability of these arrangements, they propose that data be continuously estimated over an extended period. SFBs. The performance of SFBs There were 5 confines to measure, in particular the range of products including deposits. Advances in structured finance, deposits as a means of raising capital, profitability rate similar as ROA, NIM and ROE, A geographic spread and a client base.

Jagwani (2019) With the advent of small finance banks, individuals in rural areas are now able to benefit from basic services such as credit, store, and internet banking without much difficulty. The role of the small finance bank is critical in helping disadvantaged and unbanked groups to improve their finances. Small The Bank of India will be a major player in the financial turning points and provide enormous assistance to this country's financial sectors. The provision of basic banking services and financial products to unbanked or marginalised segments of the population is facilitated by small finance banks. In the area of rural areas, they should aim to set up further bank branches.

Dhevan and Kangayan (2020) They have assessed the sustainability of small finance banks in India. In order to assess its impact on the profitability of Single Family Businesses, this study carried out correlation analyses for cost of funds and net interest margin in a number of single-family businesses. They did not find that the costs of funds affected the profitability of savings and loan banks.

Ravikumar, Murugan, and Suhashini (2020) According to the study, with steady growth of deposits and advances, small financial institutions have penetrated well across the country. In the course of the study, the ratios such as NNPA and CAR reflected sound financial positions. In addition, the research that has been carried out on the difficulties that small finance banks face in terms of restrictions on lending and banking products, limited areas of business, etc.

3. OBJECTIVE OF THE STUDY

The purpose of this study is to:

a) To analyse the financial performance and position of 10 Small Finance Banks with the help of CAMEL Model.

b) To find out the relationship between Operational, Market and credit risks.

c) To study the analysis of diversification of trend portfolio.

d) To evaluate the credit risk management practices in Small Finance Banks.

e) To identify the factors influencing the financial health and risk management practices of small finance banks.

f) To provide recommendations for enhancing the financial stability and risk management frameworks of small finance banks.

In pursuit of these goals, this research seeks to build upon existing knowledge in the areas of financial analytics and risk management, especially in the context of retail financial institutions.

3.1 Rationale of the Study

This study holds significant importance for multiple stakeholders. Firstly, it offers insights into the financial performance and risk management practices of small finance banks, enabling regulators and policymakers to develop appropriate policies and regulations tailored to the unique characteristics of these institutions. Secondly, it provides valuable information to investors, depositors, and customers, enabling them to make informed decisions and understand the risk profiles of the small finance banks they interact with. Finally, it contributes to the academic literature by expanding the understanding of financial analysis and risk management practices in the specific context of small finance banks.

4. RESEARCH METHODS

To get a better understanding of CAMEL's risk management approach in the banking sector, this study has been structured and coordinated. It will be a **descriptive type** of research. In order to gain a better understanding of the camel model for overall rating and its efficiency in assessing knowledge acquired by small finance bank, data will be collected from both primary and secondary sources. An empirical research where Camel analysis will be done on 10 Small Finance Bank.

4.1 The Sample and collection of data

To study the risk management a questionnaire will be prepared for the employees and principal officers of the bank who are in charge of the credit risk management to collect information regarding Capital Adequacy, Assets, Management, Earnings and Liquidity. 10 Small Finance bank's financial performance will be studied based upon Banks Annual reports of last 5 years to analyse the financial positions of the small finance bank which will be authentically collected from secondary sources like RBI Publications, Banks websites, Indian Institute of Banking & Finance, Journals etc. The small finance banks balance sheet, Profit and loss account will be evaluated for the application of CAMEL Model approach to know the finacial performance.

4.2 Proposed Hypotheses

In line with the objectives of the study, following null hypotheses are being formulated:

H_{01} - There is no significant difference in the capital adequacy ratio (CAR) among the 10 small finance banks.

H_{02} - There is no significant difference in the asset quality (AQ) ratios among the 10 small finance banks.

H_{03} - There is no significant difference in the management quality (MQ) ratings among the 10 small finance banks.

H_{04} - There is no significant difference in the earnings quality (EQ) measures among the 10 small finance banks.

H_{05} - There is no significant difference in the liquidity position (LP) among the 10 small finance banks.

H_{06} - There is no significant difference in the overall financial performance (FP) scores among the 10 small finance banks.

H_{07} - There is no significant difference in the financial soundness of the 10 small finance banks as measured by the CAMEL model.

H_{08} -There is no significant difference in the operational risk management practices among the 10 small finance banks.

H_{09} - There is no significant difference in the credit risk management practices among the 10 small finance banks.

H_{010} - There is no significant relation between operational risk management and credit risk management practices among the 10 small finance banks.

4.3 Tools for Data Analysis

a) CAMEL Model

b) Graphical analysis will be done using bar charts.

c) Arithmetic mean, Standard Deviations and Ratios.

d) t-Test, One-way ANNOVA, Pearson's correlation coefficient for analysis and interpretation.

5. IMPLICATIONS

This study is aimed at highlighting the importance of CAMEL model analysis. Comparative analysis of public finances in the most prominent small finance banks in India. The study can help identify the small finance banks that have a strong financial position and effective risk management practices. It can also highlight the banks that may be facing challenges in one or more areas of the CAMEL framework, indicating weaknesses in their operations. The bankers will be able to understand these various ratios by analyzing them and the financial position of the banks. They would be able to compare their overall financial status with other 10 Small Finance Banks.

The analysis of small finance banks using the CAMEL model can help regulators and policymakers assess the banks' compliance with regulatory requirements. It can provide insights into whether the banks have sufficient capital, maintain asset quality, demonstrate effective management, generate sustainable earnings, and have adequate liquidity.

The findings of the study can influence investor confidence in small finance banks. Banks that demonstrate strong financial performance and effective risk management are likely to attract more investment and enjoy higher levels of confidence from investors and stakeholders.

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7. CHAPTER OUTLINE

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